Arkansas Development Finance Authority

Development Finance Loan Policy

Adopted by the Board of Directors
August 21, 2003 ~~March 16, 2000~~

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I. <u>DEVELOPMENT FINANCE POLICY STATEMENT</u>.

The Arkansas Development Finance Authority was created by Act 1062 of 1985 (ARK. CODE ANN. ' 15-5-101, *et seq.*). ADFA=s mission is to provide access to capital for qualified activities that enhance the quality of life for Arkansans. In creating ADFA, the General Assembly found that there was severe economic instability in Arkansas resulting in an increasing number of *business failures* and *bankruptcies* and extraordinarily *high levels of unemployment* in agricultural business and industrial enterprises. Furthermore, the General Assembly found that the continued existence of these conditions to be detrimental to the citizens of the state, and that the economic well-being of the citizens of the State of Arkansas will be enhanced by the creation of ADFA to provide the means and methods for providing financing:

(1) to restore and revitalize existing agricultural business and industrial enterprises for the purpose of retaining existing employment within the state;

(2) to promote and develop the expansion and establishment of new and existing agricultural business and industrial enterprises for the purpose of further alleviating unemployment within the state and for providing additional employment;

(3) to promote and target resources of the state to further the development of export trade of Arkansas products for the purpose of economic development in the state and for providing additional employment therefrom;

(4) to assure the development of reliable, affordable, efficient and environmentally compatible sources of energy for all types of public and private consumption;

(5) to provide health care facilities for the citizens and inhabitants of the state;

(6) to provide capital improvement facilities for the benefit of the citizens and inhabitants of the state;

(7) to provide educational facilities for educational institutions within the state and to enhance the Public School Fund;

(8) to provide financial assistance to political subdivisions of the state;

(9) to assist minority businesses in obtaining loan or other means of financial assistance; and

(10) to complement Arkansas= private financial institutions to better serve their customers in ways which contribute to a strengthened and diversified Arkansas economy and which do not compete with Arkansas= private financial institutions.

ADFA is the primary bond issuing authority in the State of Arkansas which can use its own financial resources to further its mission. ADFA has a proactive, professional Board of Directors and professional management team which run ADFA as a business, and although similar, not identical, to the lending practices of a bank. ADFA is a development finance agency where economic development and related development finance activities are stated as principal program goals.

II. <u>STANDARD CREDIT POLICY</u>. For the category of **highest risk** in ADFA lending programs, the ADFA loan officers and Board of Directors shall be guided by the following standard credit policies for evaluating applications and for portfolio management. The Credit Policy shall apply to all new and existing loans.

A. QUALIFICATIONS.

Applications must comply with (1) State of Arkansas legislative and constitutional law and (2) federal tax law, its requirements and restrictions that are imposed on the issuance of tax exempt bonds.

An applicant must demonstrate and document that the project will have a positive impact on employment or otherwise actively assist in the economic development of Arkansas.

An applicant must demonstrate reasonable assurance of the ability to repay the projected debt from debt service.

An applicant must agree to comply with all rules and regulations of the Authority.

B. STATUTORY RESTRICTIONS.

ADFA=s enabling legislation, as amended, contains certain restrictions and limitations on eligible activities and borrowers (addendum attached). These are ADFA=s policies, which shall accommodate such legislation and any future amendments.

C. ELIGIBILITY.

1. <u>Borrowers</u>. Individuals, proprietorships, partnerships, corporations, tax exempt organizations, not-for-profit corporations (as defined by the Tax Code e.g. 501(c)(3), limited liability companies and municipalities.

2. <u>Amounts</u>. ~~The~~ <u>ADFA through the Bond Guaranty Program and through any direct lending activity</u> ~~Bond Guaranty Program~~ has no statutorily-imposed loan limit. $6,000,000 is adopted ~~as an internal policy~~ as an <u>ADFA</u> in-house loan limit per borrower.

3. <u>Loan to Value/Cost</u>. Loan to value/cost shall be 90% of cost or 90% of appraised market value, whichever is less for existing businesses and 70% for start-up businesses.

4. Cash Flow Coverage. For all projected and outstanding debt, the cash flow coverage should be at least a 1 to 1 coverage. Evaluation and analysis should be performed on the existing financial statements and projections using comparable industry ratio analysis.

5. Appraisals. An appraisal must be obtained for an application where ADFA is financing the acquisition of existing real estate or used equipment and appraisals must be obtained when existing real estate or used equipment is being pledged as additional security. MAI or comparable appraisals are required for real estate. Appraisals of used equipment must be performed by an independent, outside source who has proven knowledge of equipment values. Loan officers should obtain a cover letter from the appraiser addressed to ADFA if the report has been prepared for the borrower. Exceptions to the appraisal policy will be evaluated on a case by case basis using common sense.

6. Insurance. Borrowers are required to maintain insurance coverage on collateral securing loans. Upon receipt of a notice of cancellation or non-renewal of the existing insurance coverage and in the absence of a replacement binder, collateral insurance protection will be put into effect. The borrower will then be billed for the cost of the insurance protection. Once ADFA receives proof of insurance coverage indicating no lapse in coverage, the cost of the collateral insurance protection will be credited back to the borrower.

7. Collateral. On tax exempt bond issues, ADFA must be granted a pari passu first mortgage on real estate and a pari passu first security interest on equipment financed with bond proceeds. Otherwise ADFA will obtain collateral that is sufficient to secure any other loans. Additional collateral may be pledged pursuant to prudent lending practices.

8. Personal Guaranties. Joint and several or pro rata personal guaranties of owners/shareholders of ten percent (10%) or more of the company are required. A level of recommended guaranty is determined when applications are underwritten. Annual updates of personal financial statements may not be required unless specifically requested by the staff.

9. Corporate Guaranties. As needed pursuant to prudent lending practice, ADFA will obtain the corporate guaranties of related parent or sister companies.

10. Term (Maturity). The term (maturity) should not exceed the economic useful life of the assets being financed. The final maturity of any transaction should be determined after consultation with the applicant and review of projected cash flow.

11. <u>Key Person Life Insurance</u>. Life insurance may be required pursuant to prudent lending practices.

12. <u>Phase One Environmental Assessment</u>. Phase one environmental assessments on real estate should be conducted and addressed to ADFA. If any indication of problems exists, the report and its recommendations should be discussed with legal counsel. Loans which do not have real estate as collateral will not be required to have a Phase One Environmental Assessment.

13. <u>Job Creation And Job Retention</u>. ADFA will evaluate the impact on current and projected employment levels, wage rates, skill levels and local economic conditions. Preference may be given to applications that create or retain large numbers of high wage, high skill jobs in areas of high unemployment.

14. <u>Concentration</u>. Loan concentration in any one industry should be limited to twenty percent (20%) of the loan portfolio.

15. <u>Company Financial Statements</u>. Borrowers who are indebted to ADFA for amounts exceeding $1,000,000 shall be required to submit annual audited financial statements. Borrowers who owe ADFA less than $1,000,000 shall be required to submit independent CPA reviewed financial statements. At a minimum, borrowers will be required to submit semi-annual financial statements which can be internally prepared, within 45 days of the end of the second quarter of the fiscal year. The staff may require more frequent reporting on a case-by-case basis. ADFA staff will obtain Dunn & Bradstreet reports on all applications. The staff will also obtain on Dunn & Bradstreet credit reports on all participating companies on an annual basis.

16. <u>Personal Financial Statements</u>. Personal financial statements are required at the time of application and may be required at the request of ADFA during the term of any outstanding debt which is personally guaranteed to ADFA. ADFA staff will obtain credit reports for personal guarantors on an annual basis.

17. <u>Borrower=s Financial Institution</u>. Credit checks will be made by the ADFA loan officer(s) with the Borrower=s financial institution to determine project feasibility and to discuss possible financial participation. A report on this contact will be noted in the credit write-up for any credit presented by the ADFA staff to the Board or loan committee, as the case may be.

D. CREDIT RATING CATEGORIES.

1. **Class I (Highest Quality).** Companies with ample cash flow to cover existing debt. A history of stable, uninterrupted profits and the backing of local financial institutions. The company should have strong stable management who take the necessary steps to see the future outlook of the

industry in which it operates and position the company to take advantage of these trends. The company has enough liquidity to survive short-term troughs and the ability to get financing to help them through long-term troughs. The loan is secured by excellent collateral and the owners have a substantial equity position. All of the key financial ratios should fall within the upper quartile of the RMA Annual Statement Studies.

2. **Class II (Good Quality).** Companies with similar qualities of those in Class I except some characteristics are not as strong. They could have less liquidity, lower debt service coverage, or more cyclical earnings. Alternative sources of funding in slow periods are available. The companies operate efficiently now but may require capital outlays to help meet the future industry demands. There is good collateral coverage and the owners have an acceptable equity position in the company.

3. **Class III (Satisfactory Quality).** Companies with average financial statements when compared to RMA Annual Statement Studies. Profits and cash flow may be erratic but as yet the company will not have been over 30 days delinquent with any scheduled debt service payments. Alternative sources of finance are possible to help in slow periods. Collateral coverage shows at least a 100% coverage on the balance sheet but conversion to cash will be slow and prices received would be uncertain.

4. **Class IV (Below Average Quality).** Companies with poor liquidity and erratic earnings or losses. The primary source of repayment is uncertain and collateral conversion may be necessary. Collateral coverage is questionable and below market prices are assured. Industry trends are down and technological advances may make the company product obsolete. No additional sources of finance are available. Close monitoring and continuous communication with management is required.

5. **Class V (Poor Quality).** All characteristics, collateral, net worth, cash flow are substandard. Constant and intense supervision is required. The possibility of a partial or full loss is expected. Additional collateral or equity injection will be required to keep company operating.

6. **Class VI (Poorest Quality).** Loan is a loss. Debt Service payments have stopped. No chance of recapitalization exists. A full or partial loss is assured.

E. LOAN REVIEW.

1. <u>Objectives</u>.

   a. Initially to provide a current appraisal of the quality of the loan portfolio by identifying problems of each individual loan.

b. Early detection of potential problems by analyzing each individual loan on a regular schedule.

c. Keeping the Loan Review Committee updated on loans which have been identified as potential problems and action being taken to minimize ADFA=s potential loss or liability.

2. Beginning Procedures.

a. Update each loan file.

(1) Verify that current financial statements are in file, put them on a spreadsheet and analyze

(2) Based upon this analysis, assign a credit rating according to the AADFA Credit Rating@

(3) Prepare a memorandum for the file discussing this analysis and credit rating

(4) Prepare an AADFA Problem Loan Update@ (on all loans rated 3.50 or higher, have a recommendation for future action ready for the Loan Review Committee)

b. Site Inspection.

(1) Each staff person in the Development Finance Section shall set aside at least 1 day per month for site inspections until all sites in present portfolio have been inspected

(2) After the site visit the inspector shall prepare an AADFA Site Inspection Report@ for the file

3. Normal Procedures.

a. Financial Statement Annual Review.

(1) Upon receipt of each company=s year-end financial statement, add the report to the existing spreadsheet.

(2) Analyze the spreadsheet, looking for positive or negative trends in the company itself and in comparison to the latest RMA Industry Averages.

(3) Based upon the analysis, assign a credit rating according to the AADFA Credit Rating@

(4) Prepare an AADFA Loan Status Report@ (for loans rated 3.50 or higher, have a recommendation ready for the Loan Review Committee

(5) Report to the Loan Review Committee annually on each loan to include: an updated spreadsheet, an ADFA Credit Rating, an ADFA Loan Status Report and a memorandum discussing analysis and credit rating. Loans rated below 3.5 that are current and are scheduled to pay off in the next twelve (12) months are exempted from a complete annual review. Staff will report a brief status on the loan and site the reporting exemption.

b. Interim Loan Review.

(1) All loans rated 3.50 or higher (Section A-4-a) shall be reviewed monthly with the Loan Review Committee to (i) inform members of any improvements or declines in the quality of the loan, (ii) inform the members of steps being taken to rectify the situation and (iii) receive guidance from the members on other possible solutions or actions that could or should be taken.

(2) All other loans shall have their credit rating assessed on a semi-annual basis. Interim statements shall be collected from the company and staff should load the statements into the existing spreadsheet, look for any major negative trends and adjust the credit rating if it is deemed necessary. This procedure shall be conducted on a semi-annual basis.

c. Site Inspection

(1) Each site should be visited annually by the staff. The inspection should be scheduled as close to 180 days after receipt of the annual financial statement as possible. After the visit the inspector shall prepare an AADFA Site Inspection Report@ for the file.

(2) Each project should be visited at least once during the construction phase and the inspector shall prepare an AADFA Construction Inspection Report. Loans rated below 3.5 that are current and are scheduled to pay off in the next twelve (12) months are exempted from an annual site visit.

F. REPORTING.

On a **monthly** basis, the staff shall provide monthly reporting of the loan status to the Board of Directors of all problem loans and loans classified with a credit rating score of 4, 5 or 6 and on any loan ninety days past due.

On a **quarterly** basis, the staff will provide to the Board of Directors the following reports:

Remaining Term. A report of the years to final maturity by industry standard industrial code for the bonds outstanding.

Credit Quality. A report of credit scores for the portfolio by industry standard industrial code.

Portfolio Industry Concentration. A report organized by industry standard industrial code reporting outstanding balances which will be aggregated and calculated as a percentage of the total portfolio balance. Information will be presented in numeric order and in highest concentration order.

Bond Guaranty Capacity Remaining. ADFA legislation applies two tests in determining the maximum amount of bonds to be guaranteed. The two calculations will be made and the remaining capacity to guarantee new bonds will be reported.

Pre-Approval Lending Exceptions. Any exception to the credit policies occurring when underwriting and presenting lending requests must be identified an approved by the staff credit committee and the ADFA Board of Directors.

Adopted by the Board of Directors of the Arkansas Development Finance Authority this 13~~7~~th day of August ~~February~~, 2003~~0~~.

By:_________________________________
Its: Freddie Mobley ~~Karen E. Flake~~, Chair

ATTEST:

~~Rush B. Deacon, President/Secretary~~

By:_________________________________
Mac Dodson~~Layne L. Anderson~~,
~~Vice~~ President/ Secretary ~~and General Counsel~~

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